

Message Text

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SUBJ: EDRC ANNUAL REVIEW CANADIAN ECONOMY, DECEMBER 13

DEPT PASS CEA, TREAS, FRB

REF: EDR(73)23 AND ADDENDUM

1. SUMMARY. DRAFT SURVEY (REFDOCS AIRPOUCHED WASHINGTON AND OTTAWA NOVEMBER 29) NOTES ECONOMY PERFORMED WELL IN 1973, BUT INFLATION ACCELERATED AND UNEMPLOYMENT REMAINED HIGH. SHORT TERM OUTLOOK IS FOR CONTINUED HIGH RATES INFLATION AND UNEMPLOYMENT, WITH OUTPUT MATCHING CAPACITY GROWTH. CURRENT ACCOUNT DEFICIT COULD DISAPPEAR IN 1974. ACTION REQUESTED: GUIDANCE FOR REVIEW FROM WASHINGTON AND COMMENTS FROM OTTAWA. END SUMMARY.

2. PRESENT SITUATION: DRAFT SURVEY NOTES CANADIAN ECONOMY PUSHED UP TO RELATIVELY HIGH LEVELS RESOURCE UTILIZATION DURING RAPID EXPANSION LATE 1972 AND EARLY 1973. HOWEVER, UNEMPLOYMENT RATE HAS REMAINED WELL ABOVE 5 PERCENT, COEXISTING WITH GROWING REGIONAL LABOR

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SHORTAGES. THIS PERFORMANCE HAS BEEN ACCOMPANIED BY

SHARP RISE IN PRICES, WITH FOOD AND COMMODITY PRICES RECENTLY SLOWING DOWN. HOWEVER, WAGE SETTLEMENTS HAVE BEGUN ACCELERATE, REACTING TO RENEWED INFLATION, AND WITH PRODUCTIVITY DECLINING, UNIT LABOR COSTS LIKELY BE UNDER STRONG PRESSURE. SECRETARIAT SAYS CANADIAN POLICIES ARE AIMED AT MAINTAINING GROWTH OUTPUT AT LONG-TERM POTENTIAL, AND AT RELIEVING IMPACT INFLATION ON HARDSHIP CASES BY DIRECT ACTION ON PRICES AND INCOMES.

3. ON INFLATION: SECRETARIAT STATES RECENT FOOD AND COMMODITY PRICE RISES HAVE BEEN MAJOR FACTOR IN ACCELERATION OF INFLATION BUT THIS EXTERNAL INFLUENCE HAS BEEN IMPOSED ON UNDERLYING LONGER-TERM TREND PRICE AND COST INCREASES. SECRETARIAT CONCLUDES LOSS OF PRICE STABILITY SINCE 1966 CANNOT BE EXPLAINED IN TERMS PAST RELATIONSHIP BETWEEN WAGES AND PRICES OR EXCESSIVE PRESSURE ON RESOURCES. RATHER "INFLATIONARY EXPECTATIONS HAVE GROWN AND INFLATION HAS ASSUMED MOMENTUM OF ITS OWN," AND SCOPE AND EFFICIENT TRADITIONAL DEMAND MANAGEMENT INSTRUMENTS HAVE DECLINED. PROBLEM IS TO KEEP INTEREST GROUPS FROM TRYING RE-ESTABLISH TRADITIONAL INCOME DIFFERENTIALS. IT NOTES GOVERNMENT HAS NOT YET DEVELOPED COMPREHENSIVE ANTI-INFLATION STRATEGY. NEVERTHELESS, SECRETARIAT DOES NOT RECOMMEND MORE INTENSIVE USE MONETARY AND FISCAL POLICIES TO FIGHT INFLATION. IT DOES SUGGEST GOVERNMENT, LABOR, MANAGEMENT, AND FARMERS SHOULD HAVE COMMON INTEREST IN ESTABLISHING CONSULTATION MECHANISM ON INCOMES, PRICES AND POLICY ISSUES, WITH PERHAPS PRIMARY OBJECTIVE CREATE CONSENSUS ON "DESIRABLE PATTERN OF INCOME DISTRIBUTION AND RESOURCE ALLOCATION" AND ASSURE SUPPORT THESE GOALS.

4. PROSPECTS: IN CONTEXT GREATER DEGREE UNCERTAINTY THAN USUAL, AND ON ASSUMPTION GOVERNMENT POLICY WILL REMAIN EXPANSIONARY, SECRETARIAT EXPECTS HIGH RATE BUSINESS INVESTMENT ACTIVITY AND STRONG GROWTH PRIVATE CONSUMPTION TO PUSH REAL GROWTH GNP ABOVE 5 PERCENT IN 1974. DRAFT SURVEY DOES NOT CONSIDER IMPACT ON INDUSTRIAL PRODUCTION OF POSSIBLE CUTBACK OIL SUPPLIES. PRICE OUTLOOK IS "VERY UNCERTAIN", BUT RISE IN OIL PRICES WILL RAISE ENERGY COSTS THUS REINFORCING WAGE PRESSURES. GNP DEFLATOR LIMITED OFFICIAL USE

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EXPECTED RISE LESS RAPIDLY THAN 1973, BUT MAYBE NOT BEFORE LATTER HALF 1974. EXPORTS WILL REMAIN STRONG, AND SLOW-DOWN ABROAD NOT LIKELY AFFECT THEM. CURRENT ACCOUNT OUTLOOK BRIGHT, AND PRESENT DEFICIT COULD ALMOST DISAPPEAR IN 1974, AS TERMS TRADE CONTINUE THEIR IMPROVEMENT.

5. ACTION REQUESTED. MISSION WOULD APPRECIATE GUIDANCE FROM WASHINGTON AND COMMENT FROM OTTAWA. US WILL BE

EXAMINER FOR FIRST TIME. REVIEW ON DECEMBER 13 SHOULD
BE LIVELY SINCE THERE IS ALREADY APPARENT SHARP DIFFER-
ENCE BETWEEN CANADIAN AUTHORITIES AND SECRETARIAT ABOUT
CAUSES INFLATION AND THEIR CURE. MAY WE REMIND YOU THAT
EDRC IS NOT APPROPRIATE FORUM RAISE US-CANADIAN BILATERAL
ISSUES. REFOOCS, DRAFT ECONOMIC SURVEY AND MAIN ISSUES
PAPER, AIRPOUCHED WASHINGTON AND OTTAWA, NOVEMBER 29.
BROWN

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